




Nobel Winner Krugman Says 'End of World Postponed' (Update3)

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By Kati Pohjanpalo



Sept. 21 (Bloomberg) -- The global economic downturn has probably hit bottom though the recovery will be "slow and painful," said **Paul Krugman**, the Nobel Prize winning economist.

"The end of the world appears to have been postponed," Krugman, a professor at Princeton University, said at a seminar in Helsinki today. The world economy "does not appear to be falling into an abyss but is still" in trouble. The outlook is "very fuzzy" and a W-shaped recovery may become U-shaped.

Germany, France and Japan emerged from recession last quarter, adding to evidence some of the world's biggest economies are over the worst. The U.S. recession probably ended in late July or August, Krugman said, after gross domestic product fell 1 percent in the second quarter from the prior three months.

The Nobel Laureate said "the truly extraordinary thing" has been "the collapse of world trade," the subject for which he was awarded the prize last year, and he cast doubt on the potential for exports to lead the global recovery. He also said China's economy isn't big enough to serve as a growth engine.

"The problem is that this is a global financial crisis," he said. "How can we have an export-led recovery unless we find another planet to export to?"

No Locomotive

Krugman questioned whether China's economy is large enough to be a locomotive of recovery.

"One of the reasons it's so difficult to tell a story about a fast recovery is the large surpluses in Asia," he said. "If they can find a serious increase in consumer demand, that would help. We don't really understand why the Chinese savings rate is so high, but it's probably due to" large precautionary savings.

He warned that any decision by China to diversify its currency reserves away from the dollar would "hurt Europe and Japan the most."

While budget deficits "saved the world" in the short term, "for most people things are going to get worse," he said. "Governments can help us cope with the crisis, but they have levels of debt that are sufficiently high to be a source of concern."

Even so, the recovery remains too frail to warrant scaling back support measures, he said. "Exit from stimulus should certainly wait until we have clear signs that we're closing the output gap. This is no time to start exiting stimulus."

'Don't Panic'

Economies can "suffer" more than necessary if governments introduce austerity measures prematurely,

Krugman said.

"Obviously deficits are building up, but to respond with severe cuts increases the human and the economic cost right away. You do not want to inflict upon yourself the equivalent of an IMF program. You want to avoid doing that if you can. You have to keep an eye on the debt numbers but not panic over them if you can avoid it."

While, last quarter's drop in U.S. GDP was the fourth in a row, the longest contraction since quarterly records began in 1947, Krugman said the U.S. has \$1.1 trillion in annual capacity "staying idle."

The U.S. consumer "that's been such an important driver of the global economy, is exhausted," he said, forecasting U.S. unemployment may rise until early 2011.

Reason to Invest

Leading the recovery will be business investment, he said, "but what's going to drive business investment? It would be very helpful if someone could" make a discovery that would lead us out of this recession. "If we can introduce effective climate change policies, particularly the cost of carbon emissions," that "would be a reason to invest."

A "good" agreement at the forthcoming international climate change summit in Denmark "wouldn't just be good for the planet, it would be good for the recovery," Krugman said.

The crisis has hurt the euro in its 'competition' with the dollar, he said. "The international role of the euro is that it has suffered a setback. The crisis has not been good for the euro and its competition with the dollar as the international reserve currency."

Krugman said he was concerned global efforts to emerge from the crisis "could just drag on and on for a long, long time."

"The consequences of that are that you start to have problems with financing the debt and you start to have social and political problems," he said. My great concern is that this just drags on and on with severe consequences for political and social stability."

History is no guide to a path to recovery, he said.

"The trouble is, we really have no road maps. The only model is the Great Depression itself." That "was ended by a very large spending program known as World War II and we don't really want to repeat that."

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